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HEADLINE: The Number Wall St. Crunches the Most

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BODY:

The holiday season has arrived and with it the ultimate in year-end giving, bonus season on Wall Street.

Top executives of the leading financial firms are now spending hours each day huddled in boardrooms or trapped on endless conference calls, sparring among themselves to determine how big the bonus pool will be, how it will be divided among the divisions and, then, what each employee will receive.

The executives complain privately about the time that must be spent on compensating their highly paid professionals at the expense of calling on clients, recruiting talent or talking to shareholders.

"It is brain damage any way you cut it," said the chief executive of one firm, who spoke on the condition he not be identified because compensation is such a sensitive topic on Wall Street.

Nonetheless, the year-end bonus is an unquestioned tradition on Wall Street. Bonuses typically make up the majority of compensation for professional employees. In 2003, Lloyd S. Blankfein, the president and chief operating officer of Goldman Sachs made $20.1 million; only $600,000 of that was salary. Similarly, E. Stanley O'Neal, the chief executive of Merrill Lynch, made $500,000 in salary, but received a bonus of $13.5 million and restricted stock worth $11.2 million more.

An investment banking analyst right out of college, would have made a $65,000 salary and a $35,000 bonus. An associate just out of business school, might have made $85,000 in salary and a $115,000 bonus.

This year, bonuses for investment bankers are expected to rise 10 percent to 15 percent from last year, Wall Street executives and compensation experts say. While that is a fairly sharp rise, it comes off a lower base. Fixed-income traders, who have done better in recent years, are expected to see smaller rises in their bonuses. But a successful fixed-income trader is now making over all more than $1.5 million -- what a top investment banker would have reaped in 2000 -- while his or her banker counterpart is probably taking home something closer to $900,000. Bonuses for equity traders are likely to be either flat or down from last year.

"Remember the Masters of the Universe?" said Alan Johnson, managing director of Johnson Associates, the

compensation consulting firm. "They are no longer the masters. The bankers are still making less than they did in 2000, while fixed-income is making a lot more money."

The process of awarding bonuses is harrowingly subjective, based on some formula of an individual's performance, the division's performance and the bank's overall results. It is also highly political. Employees harangue employers, suggesting that headhunters have been calling and competitors are planning to pay big numbers.

"It's campaign season on Wall Street," one top executive said.

All the campaigning in the world will probably not change the results. After a strong first quarter for most Wall Street firms, executives had predicted a rise of 20 percent to 25 percent in year-end bonuses. But those expectations have since been scaled back by two consecutive quarters of slower growth.

"There was a precipitous drop-off in the third quarter, and the bonus pools are reflective of that," said Michael Franzino, senior managing partner and chief of global financial services at the employment search firm Heidrick & Struggles. "Banks will be somewhat conservative given the current economic climate."

Bonuses this year are also expected to show that the gap between the haves and the have-nots -- between those who produce the most revenue and everyone else -- is wider than ever.

Since the boom of the late 1990's, the major Wall Street banks have become more and more dependent on a shrinking breed of superstar traders and investment bankers, whose wizardly ways have subsidized a greater number of less profitable peers and divisions.

"The top-tier producers could well get 40 to 50 percent more than they did last year," said Stephen Spagnuolo, a headhunter at Sheffield Haworth who works with Wall Street executives. "And the strong areas will be fixed income, proprietary and commodities trading."

Many of these bankers are largely unknown outside their small financial circles. But to their bosses and rival banks looking to build banking teams, their names loom large.

Whether they trade commodities at Goldman Sachs or mortgage-backed bonds at Bear Stearns, these people have produced anywhere from $25 million to $100 million in revenue for their firms, banking executives say. These stars will be in a position to command bonuses of $5 million to $15 million a year. And if they do not get what they want, they could certainly make more by moving to a commercial bank eager to offer multiyear guarantees.

Indeed, even though business is sluggish, there is a hiring frenzy now for those senior producers who can bring in more than $25 million in revenue.

The compensation process starts soon after Labor Day and intensifies through the end of the year. The process is important for the simple reason that employees are the assets of a securities firm. And while the prospect of a chief executive spending as much as six hours a day on compensation issues may seem unusual, it is all part of the way Wall Street does business.

"A significant amount of time is spent around budget and bonus," Mr. Franzino of Heidrick & Struggles said. "You don't want to overpay, but you can't afford to underpay because of the recruiting environment."

Total compensation is the single largest expense item for securities firms, according to the Securities Industry Association.

This bonus season, traders will again take home a bigger share of the total bonus pie because trading -- both for clients as well as for a firm's own account, called proprietary trading -- has replaced investment banking as the main revenue engine of securities firms.

Investment banking revenues at five major firms -- Goldman Sachs, Merrill Lynch, Lehman Brothers, Morgan Stanley and Bear Stearns -- dropped 42 percent from 2000 to 2003, while net trading revenues, including principal transactions and net interest, rose 0.4 percent, according to Guy Moszkowski, a securities industry analyst with Merrill Lynch. He expects lower revenue from both new trading and investment banking for 2004 from the year before. His forecast for this year does not include his own firm, Merrill Lynch.

To be sure, the amount of the bonus is highly variable. It depends on an employee's performance, his or her relationships with clients and managers as well as various external factors.

And some firms will do better than others. Morgan Stanley's fixed-income group may pay the price for a rocky third quarter: its principal transactions dropped 62 percent in the third quarter over the same period a year earlier, a performance management attributed to an incorrect bet on interest rates. Mr. Moszkowski estimates Lehman Brothers investment banking revenue will rise 28 percent in 2004 over 2003, suggesting strong gains.

"This is a year of unusual differences among firms," said Mr. Johnson, the compensation expert.

And, of course, no number is taken at face value: negotiations will ensue. Top Wall Street executives say it is exhausting listening to all the accounts of the contributions the employee made to winning a big merger deal or landing a significant block trade.

"When you add everyone's numbers, you have more revenues than the entire investment bank," said one global head of trading at a major Wall Street firm.

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